

FHA's Distressed Asset Sale Program Should Strengthen Home Retention Goals

Dec. 26, 2012

HUD already has completed the first round of its expanded auction sale program for defaulted FHA-insured single family home loans. Due to widespread noncompliance with FHA loss mitigation requirements, homes likely are being included in the bulk sale program without adequate home retention efforts. Crucial information about the immediate and long-term effects of the sales must be available to the public. Homeowners affected by the process must have better access to remedial action for abuses. Moreover, post-sale requirements fail to provide reasonable measures to avoid unnecessary foreclosures. Protections for FHA homeowners can be strengthened while still providing needed revenue for the FHA insurance fund.

Problem # 1: The selection process for loans to be sold rewards poor mortgage servicing practices. We routinely see evidence of servicers' non-compliance with HUD's loss mitigation rules. These rules require that servicers consider homeowners for specific alternatives to foreclosure before proceeding to foreclosure sales. For example, HUD rules require a thorough review for loss mitigation at ninety-days' delinquency and monthly thereafter. Right now, many thousands of FHA-insured loans have been in foreclosure for years, without completion of these basic reviews. The FHA loan sales reward servicers who fail to conduct appropriate loss mitigation reviews. Servicers facing delays and court scrutiny in judicial foreclosure states are contributing the overwhelming majority of loans to these sales. FHA is paying off the full insurance claim in each case.

Solution # 1: The process for selection of loans for inclusion in all sale pools (both Neighborhood Stabilization Pools and unrestricted national pools) must require rigorous scrutiny of the servicer's loss mitigation reviews. This scrutiny will provide enormous savings for the FHA insurance fund.

- Servicers should be required to document compliance with each step of FHA's sequential loss mitigation review, including documentation of the grounds for each decision to deny an option, before securing permission to sell loans and before receiving FHA insurance benefits.
- Servicers who have delayed loss mitigation reviews beyond the time frames allowed under FHA rules must not be permitted to sell those loans, and payment of insurance benefits must be conditioned upon taking appropriate actions to remedy the delays.
- FHA must develop a screening tool that requires servicers to document loss mitigation reviews, and this screening tool must be developed with public input and be publicly available.

- Before a loan is referred to a loan sale or an insurance payment is made, the homeowner must receive a copy of the screening tool showing the loss mitigation review history, the options considered, and the reasons for any denials.
- FHA must develop a procedure for a homeowner who disagrees with the servicer's loss mitigation allegations to obtain review of the decisions.

Problem #2: Inadequate information is available to the public regarding the auction results and the long-term results of the sales. To date, FHA has released only aggregate data on completed loan sales. The premise of the loan sale program is that the purchasers will consider and implement home retention options that will preserve long-term homeownership for borrowers who would otherwise lose their homes. Thus far, the data provides no information about the nature of post-sale loan modifications, whether they involved principal reduction, and how affordable they are for the individual borrowers. In addition, FHA has not provided data indicating the impact of these sales on borrowers of color and other groups protected by civil rights laws.

Solution #2: Monitoring and reporting should ensure effective oversight and enforcement.

- For all loans sales, both Neighborhood Stabilization Pools and unrestricted national pools, HUD should require detailed reporting and make this reporting available to the public. The data collected must go beyond what is asked on the Ex. B-1 form to the quarterly reports now required for Neighborhood Stabilization Program pool sales completed to date. For the sales involving these pools, FHA requires quarterly post-sale self-reporting. The self-reporting should be subject to spot reviews by FHA and the data reported should include details about the quality of the loss mitigation option implemented. For example, the forms should include details about principal reduction, degree of payment changes, and long term affordability prospects for the borrower.
- HUD should assess financial penalties for substantial noncompliance with reporting requirements and contract terms.
- HUD should provide immediate public release of all post-sale management reports and supporting documentation. It is not clear to what extent HUD will make even the limited post-sale self-reporting documents available to the public. These must be made public, as should the more detailed information described above.

Problem # 3: FHA's loan sale program excludes the homeowners from all decisions made in the transactions that most affect them. Homeowners whose loans are being sold have paid substantial amounts up front at their closings in order to participate in the FHA insured loan program. They continued to make payments to the insurance fund after their closings. As it is structured now, the loan sale program abruptly cuts off insurance benefits to these borrowers while their loans remain outstanding. The decision to sell loans is made without notice to or input from the homeowners. Aside from the basic unfairness of this process, the exclusion of homeowners cuts off the one likely source of outside information related to the servicer's true performance of its loss mitigation duties before the sales. After the loan sales, the homeowner is again left without recourse when faced with abusive servicer conduct.

Solution # 3: HUD should do homeowner outreach both directly and through use of outside advocacy groups and housing counselors to document borrower complaints and to seek redress where appropriate.

- HUD should implement a system of notices to homeowners that accurately informs them about the sale process, the servicer obligations before and after sales, and what their rights are as the parties most affected by these transactions.
- HUD should develop an effective review system consistent with due process to handle homeowner complaints about conduct of post-sale servicers and owners.

Problem #4: Under the current Neighborhood Stabilization Program rules, post-sale requirements are vague and hide abuses. Among the outcomes that will count toward satisfaction of a purchaser's Neighborhood Stabilization Program obligations, purchasers will often choose sale of the property to a purported owner-occupant and collection of payments from an existing borrower for six months. According to the Neighborhood Stabilization guidelines, the credit for sale to an owner-occupant goes to any transaction involving a buyer who states he or she will live in the home for one year, without ensuring longer-term owner occupants are involved. This vague provision invites abuse and manipulation by investors and speculators. Credit for maintaining a loan in current pay status goes to any payment arrangement that produces six monthly payments, regardless of how those payments were achieved or what happens after those six months. Purchasers are not required to screen homeowners for any specific type of loan modification, despite general industry standards that determine how to modify a loan to achieve affordable payments. The post-sale guidelines do not ensure that sustainable loss mitigation will be provided to struggling homeowners. The guidelines also provide no remedies for borrowers who are abused or misled by servicers of the acquired loans.

Solution #4: Post-sale requirements for Neighborhood Stabilization pools must be revised to ensure transparency and accountability.

- Homes should be sold to genuine owner-occupants and oversight and reporting should be used to ensure such outcomes. The criterion for owner-occupancy should require occupancy either by the pre-sale owner or by a new purchaser for the entire four-year reporting period.
- The criteria for loan modification must be tied to a percentage of income payment level and a one year record of successful payments.
- Purchasers should be required to make affordable loan modifications where consistent with investor interests. Servicers who mislead homeowners or otherwise engage in abuses should be subject to explicit administrative enforcement measures including effective monetary penalties, and should be directly accountable to the homeowners.

Problem # 5: The overwhelming majority of loans sold thus far have gone to private for-profit investors. When it announced the expansion of its loan sales program in June 2012, HUD extolled the benefit of involvement by community-based non-profits. According to HUD, the non-profits would buy loans and work with homeowners to provide sustainable options. The results

from the September 2012 sales of loans in all categories indicate that about 400 loans were sold to community-based non-profits, while about 9,000 were sold to for-profit investors. Non-profits are most likely to work with homeowners to best explore home retention options. Entities holding the loans in portfolio are also more likely to seek sustainable homeownership outcomes than trusts managing securitized debt.

Solution # 5: For all categories of loan sales, promote non-profit purchases and require private investors to seek sustainable outcomes and provide detailed reporting.

- HUD should prioritize bids from buyers who will hold the loans in portfolio rather than securitize them.
- HUD should require that a higher percentage of bidders be community-based non-profit entities.
- To the extent that sales to private investors go forward, the private investors should be subject to the same outcome goals and reporting requirements as the neighborhood stabilization buyers.